CHAPTER ONE

FINANCIAL INSTITUTIONS AND PRIVATE CORPORATE SECTOR IN INDIA

1.1 *Introduction*

Over the past several years, a plethora of empirical studies have documented that savings, investment and growth of an economy are highly correlated. In fact, savings determine the rate at which productive capacity, and hence, income can grow. On an average, the more rapidly growing developing countries have had higher savings and investment rates than the slower growing countries.[See appendix-table 1] However, empirical studies also revealed that the vital factor influencing income levels, there by savings and investment is, how productively savings have been used, even more than how much was saved. This is reflected in the fact that during the last 25 years average gowth rate of developing countries have been more correlated with the productivity of investment than with the rate of investment.[1] The extent of efficient use of investible resources makes the biggest difference between rich and poor nations.[2] The financial systems contribution to growth lies precisely in it's ability to increase effeciency.

While attempting to develop a comprehensive definition of financial system, authors have duly emphasised its role as a keeper of efficiency. Such as, "the capital market of a modern economy has two basic economic functions, first, the allocation of a periods current savings among users and uses or the supply of financing for the periods' investment; second, the transfer of

existing assets, tangible and intangible, among individual groups, units, sectors and countries". [Goldsmith, 1965]. Thus apart from financing projects , the market has a role as transfer house that permits portfolio adjustment from inefficient units to efficient units. Robinson and Wrightsman's also maintain the same tune, "the two functions of financial markets are to provide a link between savings and investment for the creation of new wealth and permit portfolio adjustment in the composition of existing wealth." [Robinson & Wrightsman, 1974]. In an unequivocal term, here also the authors emphasised the importance of allocative function of the financial system. Capital markets continually transfer resources from inefficient or unprofitable units to units which are efficient or profitable. By this process, financial system assures best possible use of capital resources of the community and keeps a constant pressure on the users of funds to increase efficiency. Such a well planned financial system can serve as a tool in implementing developmental strategies and their synergestic effects are a *sin qua non* for a welfare state.

1.2 *Development of Financial System : Trend of Financing of Indian Industries : ------ a Brief Review.*

The close nexus between a well-developed financial system and economic growth was realised in India only after independence. It was felt, that a financial system overwhelmingly dominated by the Government could only ensure planned economic growth of our country and then the Reserve Bank of India was nationalised in 1948. The post 1950 period witnessed a series of transfers of privately owned financial intermediaries to public control. In the

year 1956, State Bank of India was formed by taking over Imperial Bank of India and the Life Insurance Corporation came into being formed by nationalising 245 private insurance Companies. Unit Trust of India came into existence in the year 1964 under the UTI Act 1963 and history witnessed another landmark event in 1969 when fourteen commercial banks were nationalised. Gradually fourteen more banks were nationalised increasing the number to twenty-eight. In 1972, the General Insurance Corporation of India was formed as a result of nationalisation of four general insurance companies and their amalgamation into a single organisation.

During this period, there was a simultaneous growth of a plethora of development banks as the backbone of the Indian financial system. The objective of incorporating these development banks was not only to povide long term finance to industries but also to act as active agents for promoting socio-economic development. The establishment of a chain of development banks started with the setting up of the IFCI in 1948. Later in 1951 , the Government of India enacted the State Financial Corporation Act, which came into effect in 1952, As a result of this, a battery of State Financial Corporations were established in different states. Again with the primary objective of assisting industrial investment in the private sector, the Industrial Credit and Investment Corporation of India was set up in the year 1955. In 1964, the Industrial Development Bank of India was set up to function as the apex body for co-ordinating the activites of the financial institutions, for providing finance to industries and for promoting developmental activities in backward areas and for looking after sick industries. Special attention was given to

rehabilitation of sick industries when the Industrial Reconstruction Bank of India (formerly IRCI) was established in 1971.

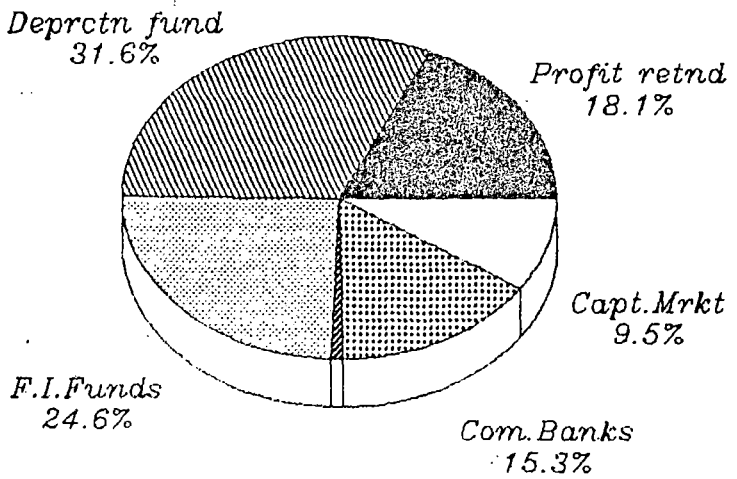
Thus in our country, the whole financial system is mainly dominated by the Government. However, apart from these Government controlled financial institutions, stock exchanges have been re-inforcing the financial system since the last century. After the setting up of the first stock exchange in 1887[3]. 15 stock exchanges hase been gradually instituted to date, to meet the growing needs of users. In addition to this, internal resources which include retained profits and depreciation funds were also used to finance Indian industries .

With these preliminary discussions on the Indian financial system, we shall study in the next section the trend of financing of Indian industries. This would show the relative importance of different sources financing and the role they can play to achive the objectives of the financial system.

1.2(a). *Trend of financing of Indian Industries*

The private corporate sector derives its funds from internal sources such as depreciation funds and retained profits and, also from external sources vide the issue of shares and debentures, deposits from public and assistance from financial institutions and commercial banks. The trend of corporate financing which has been envisaged by the Rangarajan committee[4] reveals very interesting information.

FINANCING OF TARGETED INVESTMENT OF PRIVATE CORPORATE SECTOR



PERIOD 1982 TO 1984-85

The diagram clearly reveals that private corporate sector's relieance on the financial system is only about half of their total investment requirements. Internal sources viz. depreciation funds and unapportioned profits supply the other vital half.[See appendix table II] Among the external sources the financial institutions together with the commercial banks shoulder 80% of the responsibility leaving the stock market to play a very insignificant role.

A critical analysis of the above trend of financing may unfold several serious issues which have significant relationship with the present discussion.

Though generation of half of the funds internally seems quite large, however it is not something to be happy or complacent about. Depreciation funds which account for about 64 per cent of internal sources are constantly used for replacement of worn out equipment and cannot be used for dilation and growth of the business. It is only 36% of the internal sources i.e., retained profits which help the companies in this respect.

A study of the financing pattern of corporate sector reveals that the gross fixed assets are mainly financed from internal sources and external sources consequently are being used for financing current assets only.[See appendix Table III]. It would be erroneous to match individual sources with uses of funds on the basis of aggregate data only. However, if only the retained profit is considered which is in all practical sense the actual funds that are available fo the expansion of the business then the average ratio between undistributed profits and fixed assets expansion averages to above 30% . The importance of internal

financing as an important sources of fund can also be observed in industrially developed countries. Gordon Donaldson's study based on U.S. industries shows that firms largely rely on self-finance and raise a small portion of their investible funds from the market.[Donaldson G, 1961]. Simon Kuznets, in another study, covering a period of more than fifty years indicated that in American industries, the amount of gross internal savings exceeded that of external sources of funds.[Kuznets. S. 1961].

Among the external sources the nominal role of the stock market also clearly emerges from the above study. The seventies witnessed a scene where only about 4 to 5 per cent of the fixed assets formation was financed by new issues.[See appendix Table III]. This was due to several causes like uncertainties of new issues, high transaction costs, random speculation and lack of good infrastructure. However, the position improved considerably from the early part of the eightees when new issues were able to provide about 13% of the financial resources of the corporate sector. This sudden improvement was due to various promotional and other measures taken by the government during the period.[5]

Under such conditions the government controlled financial institutions had to supplement the capital market for providing industrial finance. The magnitude of assistance sanctioned by the financial institutions vary from year to year depending on capital market conditions. It would be worthwhile to mention here that in the 50s an early 60s the bulk of resources, apart from internal savings came from the capital market which remained quite active. Since the middle of sixties the capital market was rather subdued and the corporate sector had to place heavy reliance on the funds

of financial institutions. Past trends reveal that 35 to 40 per cent[6] of new investments including inventories in the private sector had been financed by different govenment controlled financial institutions.

Tremendous support rendered to the corporate sector by all Indian financial institutions can be exonerated from the fact that there had been an average annual growth rate of sanctions of over twenty per cent. From a meagre Rs. 118 crores in 1964 the cumulative assistance sanctioned upto March 1987 has capered to a collossal of Rs. 40544.8 crores thus registering a growth of 34260 per cent in only 23 years.[See appendix - table IV] Out of this total the major portion was channelised to the private corporate sector. Recent trends show that about 75% of the funds were allotted for this sector against an allocation of only 15% to the public sector, 7% to the joint sector and the rest to the co-operative sector.[See Appendix Table V]

Thus, from the above discussions the following important points come to the limelight.

(i) Importance of internal sources of financing for the growth of the private corporate sector.

(ii) In general, insignificant role of he stock market.

(iii) Tremendous importance of government controlled financial institutions as suppliers of funds for the growth of the private corporate sector.

Very often, while evaluating the effectiveness of any financial system, its capacity to supply funds is overemphasised while undermining its role as a watch dog of efficiency. Thus oneof the basic ingredients of an efficient financial system gets out of

our sight. This is clear from the tendency to gauge the level of activity and the role of financial institutions in the development process of our economy, only on the basis of magnitude of funds supplied to the industries. This approach ignores the role of the finacial system as the "gaurdian of efficiency" [Baumol 1965] and it's developmental implications. In absence of an active stock market, financial institutions as major suppliers of funds has a definite role to play in this respect.

Efficient market allocation, or direct participation in management are the two alternatives available to financial institutions to ensure efficient utilisation of resources. Efficient market allocation of resources can be made by financial institutions through channelising funds to the efficient units only and denying inefficient units of financial resources. However, this requires a constant re-shuffling of resources from inefficient to efficient units. If for any reason this practice cannot be applied, then productive use of funds can be ensured by the financial institutions through direct participation in the management of the corporations. Considering the multiple, some times conflicting objectives[7] that the government tries to pursue through finiancial institutions and also the existing condition of the stock market , it seems that the second approach, i.e. the intervention in the management is the easiest means to ensure efficiency. This would necessitate a critical analysis of the volume of equity holding of the private corporate sector by financial institutions.

This factor is important, because it is by virtue of this equity holding that financial institutions can become members

of boards and control and guide the corporations to ensure sound economic development.

1.3 *Equity Holding of Financial Institutions and Its Importance in the Corporate Power Structure*

The discussion in the previous section provides only an aggregate picture of the assistance granted to the corporate sector by the financial institutions. The major components of this assistance however are (i) rupee loans (ii) foreign currency loans and (iii) underwriting and direct subscription of corporate securities. Among the above three components the major portion of assistance is in the form of rupee loans, accounting for more than seventy-five per cent.[See Appendix Table VI] Underwriting and direct subscription occupied a large share in the sixties. Though the amount has decreased to about fifteen per cent of the total assistance in the eightees, yet it serves as a vital mode of assistance to the corporate sector. The underwriting operations of the financial institutions are consistent with their theoretical concept of developmental agencies. They have several times been affected by the depressions and booms in the capital market, but have always kept up their efforts to support new issues at times when other underwriters have disappointed the market. Other than this quantitative dimension in terms of rupees channelised for underwriting, this has another important qualitative dimension also. As M.Y. Khan puts it, "their participation lends prestige to the issues and conveys to the investor an implicit guarantee regarding the soundness of an issue."[Khan ,1983].

What has been the impact of such underwriting activities of the financial institutions? Recent studies show that all other categories of underwriters and direct subscribers have been outstripped by the financial institutions and that they have been contrieved into a near elephantine structure.[8] [Also see Appendix Table VII].

The cumulative effect of underwritng and subscription of equity share and convertible debentures, conversion of term loans to equity, frequent issue of right and bonus shares by companies have eventuated for a very interesting pattern of equity shareholding by the financial institutions. A steady rate of increase has been observed for the equity holdings of financial institutions acdompanied by a decline in the holdings of the individual. The following analysis will highlight the changes.

Table 1.3(a)

Trend in Ownership Pattern of Equity Shares of Private Sector Companies

(Percentage of paid up value of equity)

Category of owners	1959	1965	1978	1982	1986
Individuals	51.82	46.78	36.96	43.79	41.93
Financial Institutions	6.64	18.82	27.37	29.39	23.95
Govt.& Semi Govt Bodies	0.00	1.30	1.39	0.44	0.22
Joint Stock Companies	39.46	31.69	32.85	23.89	32.26
Trusts & Charitable Inst.	1.15	1.29	1.26	0.64	0.33
Others	0.93	0.12	0.17	1.85	1.31
Total	100	100	100	100	100

Notes :- i) Financial institutions include **IDBI,ICICI,IFCI,UTI,LICI,GICI,IRBI,**Public Sector commercial banks and other banks and also State Level Financial Institutions.

ii) For detailed break up of holding by financial institutions see **Appendix Table VII.**

SOURCE :- Compiled from (i) **RBI** Bulletin, February **1983, P. 91** and

(ii) **IDBI** Report on 'Ownership Patten of Shares and Debentures of Companies',**1989,P. 7.**

It is clear that the equity shareholding of corporate bodies by the financial institutions during the late fifties was very nominal and the individuals and joint stock companies were the primary shareholders. But, within a period of only six years, a noticable change was obseved. The percentage of equity shareholding by financial institutions increased three folds to 19% of the total. Simultaneously, the shares of individuals decreased by more

than 5%. The process of transfer of shares from the pockets of the individuals to the bags of the financial institutions became a regular feature thereafter. The rate of decrease of share ownership was of course much slower for individuals as compared to the high rate of growth of shareownership of the financial institutions.[9] There was a sudden break in the pattern of change in 1986 when there was a marginal fall in the shareownership of the institutions. It seems that continuing improvement in the activities of the stock markets since the begining of the eightees lured the investors and relieved institutions to some extent from equity financing of industries.

During this period intercorporate holdings or equity holdings by joint stock companies were observed to be above 30% throughout the period except for 1982 when it was only abont 24%.

A very recent survey conducted by the Economic Times of India also found that financial institutions have come to acquire large volume of equity shares of corporations. The study was based on 250 corporate giants and found the following pattern of shareholding.

Table 1.3(b)

Ownership Pattern of equity share of 250 Corporations

Categories of Owners	Equity Capital%
1. Resident promoters	21
2. Foreign Collaborators	17
3. Non-resident Indians	3
4. Financial Institutions	23
5. Public	36
	100

(SOURCE :- THE ECONOMIC TIMES, 16TH OCTOBER, 1989, P. VI.)

The table clearly shows that among the five categories of owners, excepting "public", who are mainly scattered and disorganinsed, financial institutions appeared as the biggest organised shareholding group. Further, studies conducted by Industrial Developement Bank of India and Economic Times show almost indentical percentage of equity holding by financial institutions. The study also shows that the top 50 companies with highet market capitalisation had an equity participation of 25% by financial institutions against 16.6% by residential promoters . The study group further reveals that the financial institutions have emerged as the single largest group of shareholders in as many as 61 Companies out of the 250 corporate giants.[10]

After such aggregative analysis, it becomes necessary to undertake a cross sectional analysis to ascertain industrywise equity holding and thereby capacity to control firms by institutions. The amount of equity ownership in most industries do not deviate significantly from the average. However large shareholdings by financial institutions are observed in electricity generation (56.69%), paper and paper products (40.52) and metal products (27.4%). Abnormally low shareholdings are noticed in Jute textiles (3.74), other textiles (13.07 and hotels and restaurants (2.37). The major portion of shares of hotels and textiles (more than 60%) are owned by the joint stock companies. It seems that the financial institutions emphasise more on capital intensive industries. However, in general, the institutions appear as major shareholders in nearly most of the industries. [See Appendix Table IX]

Another fact which may be of some interest to the readers is that the financial institutions, as compared to individual shareholders, hold more equity in new companies than in existing companies. This is clearly shown in the following table. This phenomenon may be due to the fact that individual shareholders are generally risk aversers in nature and do not venture for investments about which they are more or less ignorant. In such situations, it falls upon the financial institutions to back up new issues. These 'gap-filling activities' of the institutions is also a possible cause of rise of their equity holding.

Table 1.3(c)

Pattern of Shareholdin g of Individuals and Financial Institutions in N ew and Existing Companies

(Percentages)

	Year 1965		Year 1978		Year 1986	
	Existing	New	Existing	New	Existing	New
Individuals	47.25	26.34	37.60	32.86	34.12	43.33
F.I.	17.87	24.88	24.82	42.60	22.31	25.35

Note :- The reversal of trend in 1986 is due to the boom in the stock market in the eighties

SOURCE :- Compiled from (i) RBI Bulletin Feb. 1989, op. cit.

(ii) IDBI Report 1989, op. cit.

Normally, a large volume of equity shares in the hands of a group or individual bestows on them potential to control the company. Alternatively, if a company has a large equity base accompanied by a widely diffused group of shareholders the possibilities of control over the company by any such group becomes attenuated. However it is difficult to establish a relationship between control and volume of equity holding and also to mention

any specific cut- of rate in this regard. In general larger the voloume of holding, more is the possibility of getting control over the company. Thus in order to understand the relative importance of each category of investor in the corporate power structure, it would be necessary to have a discussion on the distribution pattern of equity holdings of financial institutions and individuals.

IDBI's study based on 575 sample companies in 1986, show that individuals held upto 25% shares in 25.74% [See Appendix Table X] of the companies but financial institutions held such shares in 63.65% of the companies. In another 151 companies (26.25%) the financial institutions held 25% to 50% of the equity shares. Share ownership above 50% by financial institutions were observed only in 58 (10.1%) companies. In contrast to this more than 50% shareholding by individuals were noticed in 215(37.39%) of the companies.

Though large volume of shares in majority of the companies were mostly under the control of individuals, the average concentration and size of holding were observed to be quite low. The analysis shows though more than 99 per cent of the total accounts were held by individuals it provided only 35 per cent of the aggregate capital and the of the sample firms average size of holdings was only Rs. 1,300. But financial institutions holding a very nominal number of accounts (0.0007%) provided as much as 23 per cent of the total capital, with an average size of more than Rs. 10 lakhs. It ~~appears from the above discussion~~ becomes evident from this, ~~is~~ that the financial institutions having concentrated volumes of equity shares possess potential controlling power.

1.4 *Pattern of Financing :*
Change in Corporate Power Structure :
Role of Financial Institutions in the Private Corporate Sector
Some issues for discussion :

Now, we feel that, there is the necessity to put the whole disscussion made so far into a proper perspective. The impact of present trend of financing, change in the power structure of corporations have to be studied in the framework of it's developmental implications. Precisely, an attempt is made to study how this change may affect the efficient allocation of scarce financial resources.

The trend of financing of Indian industries clearly unveils the insignificant role of the stock market as supplier of funds. It can be said that the most important function of the stock market is to allocate the resources of the community to their most profitale uses. Apart from this task of efficient allocation of new investment resources, another vital task which the securities market may normally be expected to perform is to ensure the profitable use of exising resources. These allocative functions of the stock market are executed through pricing of corporate securities. By fixing higher prices to the securities of the corporation with higher prospective return on investment, and lower price to those corporate securities with lower expected return on investments, the market can assure that the more efficacious companies have inexpensive admittance to investible funds.

However, efficient allocation of investible resources through stock market requires that " equilibrium prices rule and relative share prices accuratly reflect the relative earning prospects of various firms". [Baumol, 1965]. Activities of

financial institutions viz. LICI, GICI and UTI have some disturbing effects on the efficient functioning of the stock market. The concentration of investible resources in their hands disallow the free interplay of different factors in determination of security prices. The collousus volume of funds commanded by them often have a disturbing effect on the market by altering the ordinary pattern of purchase and sales. This means that a sudden large purchase of equities of a corporation by financial institutions may result in an abnormal soaring of market value of those securities. Apart from this, there are numerous reasons that forces us to belive that the actual share market price is far from equilibrium . It obviously does not permit the stock market, in practice, to act as an efficient allocator of resources as has been envisaged by theoreticians.

Further, allocative functions of the stock market has been diluted to a great extent by the ever expanding volumes of funds supplied to the corporate sector by the financial institutions. However, there is the scope of rewriting the statement in the way, that in general an inactive stock market forces financial institutions to act as a saviour of the corporate sector. When the dependence of the corporations on the stock market is minimum, it looses it's significance as an "efficient allocator of resources" and "gaurdian of efficiency" [Baumol, 1965].

Again, inactive stock markets encourage firms to rely more on internal savings for growth and development. This is a laudable trend in developing countries. But in industrially developed countries where stock market is sufficiently active, there is also a deliberate attempt to generate bulk of funds

internally. Probably, the reason for this type of behaviour is probably, it allows firms to avoid stock market discipline. Thus, management enjoys wider discretion over the use of funds and take decisions with little regard to the stock market reactions.[11] However, in India, the fact is, either by articulation or under compulsive forces by relying more on internal sources, firms have been able to bypass capital market discipline to a large extent. Under such situation misutilisation of resources seems to be a possible outcome.

1.4(a) *Role of Financial Institutions in the Corporate Sector:- The present debate.*

In the context of the above discussions, the question that immediately comes to the surface is whether the present role pursued by public financial institutions, a major constituent of the Indian capital market is conducive to promote corporate efficiency ? If not, then how to redefine the role to make it more purposive.

Some argue that institutions must give up their present indifferent attitude to inculcate efficiency in the corporate sector. It is widely known that where management is free from all constraints, be it from the shareholders, stock market etc., inefficiency is the natural outcome. Public financial institutions, a dominant partner of Indian capital market, under these situations cannot shrug off their responsibility as " watch dog of efficiency. If they do so they will be failing to do justice to their roles as investors and developement agency. Normally these two roles converge into a single point that aim at efficient use of

scarce resources.

The argument roles in this manner; the investible funds of the financial institutions do actually belong to the public. As trustees of public money institutions have an obligation to ensure adequate returns on their funds. Once this obligation is bestowed on institutions it becomes imperative for them to bring about efficiency in firms where their funds have already been invested . Change in the power structure of corporations in favour of Government controlled financial institutions provides an excellent opportunity to inculcate element of efficiency in the corporations so as to protect the interests of the investors as well as the total economy. In fact various committeees including the much debated Dutta Committee [12] insisted that public financial institutions should progressively participate in management and control of assisted enterprises so as to ensure public interest.The views got further momentum in recently when the Prime Minister almost echoed the same feelings stating that we have a vast range of financial institutions through which indirect controls, can in principle be exercised for the management of the industrial sector in a purposive manner.

Further, the present state of relationship between owner and manager of Indian corporations further reinforces the need for vigilant attitude of institutions towards corporate management. One of the peculiarities of the Indian companies is, in contrast to the high proportion of shareholding of the financial institutions, the shareholding of the groups or families actually administering the companies is very negligible. [Gupta 1984]. Indifferent attitude of institutions along with their almost

unconditional tacit support to the promoters, permits management with little shareholding to enjoy actual control over the firm. Present boards can never be characterised as " owner manager" , at best they can be described as "controller manager". [Marris, 1964]. If there is a separation of ownership from management, the presence of different vices associated with it cannot be ruled out.

This of course has a close resemblance with the seenerio in industrially developed countries where about two per cent equities belong to the board.[Marris, 1964]. However since financial institutions in those countries belong to the private sector and shares are widely dispersed among various insurance companies, investment trusts, housing societies and banks, concerted voting efforts are usually absent. Thus management with nominal equity holding remain free from shareholders influence and execure effective control over corporations. But, financial institutions through continous reshuffling of their portfolios and channelising their funds to more lucrative projects, play an indirect role to discipline management. Through this process institutions discharge their allocative functions and indirectly pressurise management to improve efficiency. In contrast to the developed countries, in India, owners are unwilling (not incapable) to exert any influence on management and incapable of imposing any direct control on them.Thus there is greater posssibility of careless use of resources by Indian management.

However, counter arguements supporting managerial autonomy is not devoid of any logic. It is always stressed that, financial institutions as development agencies of the government have the responsibility to monitor the affairs of the economic

system in consonance with the strategic policies of the state. This implies, that in India, financial institutions should not interfere in the co-exixtence and harmonised functioning of the public and private sectors. This direct participation of financial institutions in private sector may go against the very essence of mixed economy. It is strongly supported that any undue interference of the government in the management of corporate sector contrdicts the philosophy of a mixed economy. Memorandum submitted by F.I.C.C.I. to Narasimham Committee emphasises on "independence of management","competitive efficiency" and "protection against any move to " destabilise existing management". Practically, while dealing with the issue of the role of nominee directors, the memorandum concludes that already there is enough monitoring on corporations by government agencies, and financial institutions should not duplicate their functions. The arguement goes further to say that the existing controls and regulations should be reviewed and the normal laws of Economics should be allowed to operate.

Further, utter failure of different controls and their counter-productive results are frequently cited to prove ineffectiveness of Government interference in the corporate sector. Thus, it is argued that, involvement of the Government in the management of corporations, instead of improving will be instrumental for accelerated deterioration of the efficiency of the firm.

However, the debate on role of institutions in the corporate sector is always on the anvil and there is an incessant point-counterpoint rally. The root of this debate is imbedded in

the basic philosophy of mixed economy. Arguments and counter arguments are largely overshadowed by ideological bias, either upholding the need for Government control or emphasising on the potentials of the market mechanisms for efficient use of resources. In view of these conflicting assertions, it is felt that this debate is to be resolved on the basis of some objective criteria and therefore the present study is in this direction.

Various constituents of a financial system in their own way atttempt to satisfy the objectives of raising and allocating funds. Through their co-ordinated efforts does ultimately an efficient financial system emerge. Continous reshuffling of portfolio and therby channelising of funds to their most profitable use , are the practices very often followed by the institutions of developed countries to discipline management. Thanks to various constraints within which Indian institutions have to function, these functions have little relevance in India ! But institutions' unquestionable importance in the corporate power structure bestows on them the right to control and thereby discipline existing management. But the debate remains open whether there is any justification for public financial institutions to exercise this right ? If yes, then to what extent should exert themselves ? The answers to the above questions depend on how efficiently "controller managers" use the funds of the real owners and this will ultimately decide the behaviour of the owners towards the "controller managers" of the corporations.

Thus we shall specifically seek answers to the following queries:-

(a) Can financial institutional equity holding affect the

financial behaviour of private sector corporations ? If so, then to what extent ?

(b) Can financial behaviour of corporations where institutions hold large equities be discriminated from that of those where individual or group ownership is large ?

Before providing answers to these questions, it would be rational to examine what economic goals "owner managers" and "controller managers" distinctly try to pursue.

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NOTES (CHAPTER ONE)

1) The correlation co-efficient between the average rate of growth rate of GDP between 1965 and 1987 for developing countries and comparable data for the ratio of Gross Domestic Investment to GDP is 0.36. The correlation Co-efficient for the same countries over the same period between GDP growth and IOCR (the rate of GDP growth to investment) is 0.84.

"Historically, the quality of investment has been at least as important to growth as quantity. Although the fastest growing countries had higher rates of investment than the others (see appendix I) empirical studies generally find that less than half the growth in ouput is attributable to increases in labour and capital. Higher productivity explains the rest. Higher labour productivity reflects better health,skills,education and work effort; higher capital productivity reflects technical progress and more efficient use of savings" [World Development Report 1989,PP 29-30]

2) It is a fact that the quantity of resources have not always determined wealth. In 1870, Australia, a country rich in natural resources, had twice the per capita income of Switzerland ; to day Switzerland's per capita income exceeds Australia's by more than half. During the past thre decades Hong Kong, Japan, the Republic of Korea, and Singapore have had among the world's highest per capita income growth rates despite their relatively poor resource endowments. Resource rich Argentina has hardly grown at all.

[World Development Report 1989]

3) The first stock exchange i.e.'The Native Share and Stock Brokers Association', was founded in Bombay in the year 1887 to facilitate negotiation, purchase and sale of securities. Gradually other

stock exchanges were instituted at Ahmedabad (1894). Calcutta (1908), and Madras (1937). he next five decades witnessed a mushroom growth of these organisations and today there are 15 stock exchanges recognised under the Securities Contract (Regulation) Act 1957.

4) This study group was appointed by the Planning Commission under the Chairmanship of C.Rangarajan. Deputy Governor, RBI to examine factors influencing corporate investment and suggest how the private corporate sector can fulfil the desired level of investment as contemplated in the 6th plan. The report was submitted in 1982, November. (See Appendix Table I.)

5) The promotional measures by the government included (i) rationalisation and modification of personal and corporate tax laws (ii) delicensing of twenty five industries (iii) raising interest rates of debentures of non MRTP and non FERA companies from 13.5 to 15 percent (iv) raising the assets ceiling of MRTP companies from Rs. 20 crores to Rs. 100 crores (v) setting up of the Securities Exchange Board of India, etc.

6) Government controlled financial institutions supplied about 35 to 40 of the new investments of the private corporate sector.

[**SOURCE** :- Memorandum to Narasimham Committee, **FICCI, P.5**]

7) Such objectives may be :- (i) Ensuring adequate returns on the funds supplied by the institutions, (ii) Amelioration of sick units, (iii) Discouraging concentration of economic power and wealth, (iv) Disciplining erring management, (v) Providing cheap sources of capital etc.

8) Among the many financial institutions in India, a high concentration of activity in the area of underwriting and direct

subscription was noticed for Life Insurance Corporation, General Insurance Corporation and Unit Trust of India. Out of the total equity holding by all financial institutions, LICI,GICI, and UTI occupied 66% and 48% in the years 1978 and 1986 respectively. Even in 1978, the shareholding of all public sector commercial banks and all state level financial institutions were less than that of LICI. Undoubtedly, these three organisations have been the leaders in accelerating the pace of equity acquisitions.

9) The annual growth rate of equity share ownership of corporation by financial institutions were 11.14% for the period 1959 to 1986. During the same period equity share ownership by individuals declined at an annual average rate of 0.78%.

10) The pattern of share ownership with an increasing bias towards institutional investors is prevalent not only in India but in other contries also. The ownership patterns of U.K., Japan, and U.S.A. provide suitable examples.

Ownership patterns of shares-

International Comparison (% of equity holding)

	Japan		U.K.			U.S.A.		
	1950	1978	1960	1975	1980	1965	1970	1975
Individuals	61.0	31.1	54.0	37.5	35.0	51.7	64.1	52.7
F.Institutions	12.5	36.5	28.4	26.3	31.0	15.0	11.9	14.7

SOURCES :- Compiled for **RBI** Bulletin **1989**

The shift of equity shares from the individuals to the financial institutions is also a notable feature there. However this shift is not very prominent in U.S.A. The difference from the Indian scenario is that the financial institutions belong to

the public sector whereas in the other countries the financial intermediaries mainly belong to the private sector and have a close nexus with industrial houses.

11) According to Ajit Singh in U.S. there are a large number of quoted firms which rely almost on self-finance and for which finance is of negligible importance . These firms are clearly able to survive despite the stock market pricing process, although it could be argued that their growth would be limited relative to the firm which do make use of external finance.

[Ajit Singh, 1971, p-4]

12) Industrial Licensing Policy Enquiry Report,1969, New Delhi, Paras- 2, 17:7, 90 and 8:18.

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APPENDIX (CHAPTER ONE)

TABLE 1

Savings and growth in developing countries, 1965 to 1987

Country group by GDP growth rate	Gross national savings/GDP	Gross investment /GDP	Change in inv/GDP	M2/GDP
[High growth-over 7%]				
Seven Countries	28.0	28.6	26.3	43.0
Excluding China	23.2	26.7	33.1	--
[Medium growth-3-7%]				
Fifty one Countries	18.5	22.6	23.6	31.2
[Low growth-less than 3%]				
Twenty two Countries	19.0	19.0	10.1	23.8

Notes for the table :- (a) Data are weighted average times 100 and are based on a sample of eighty developing countries. M2 is currency in circulation plus demand, time, and savings deposits at banks. Investment is gross domestic investment. (b) Because of lack of data, average is for 1977-87 only.

SOURCE :- IMF, International Financial Statistics, and World Bank Data

(adapted from World Development Report, 1989. The World Bank)

TABLE II

Financing of Targeted Investment by Private Corporate Sector during 1982-83 to 1984-85

	Rs. crores		Percent of total	
(1) Targeted investment	16,085		93.43	
(2) Sources of Financing				
(a) Internal		8,639		50.18
(i) Depreciation	5,490		31.89	
(ii) Retained profits	3,149		18.29	
(b) External		8,577		49.82
(i) Financial institutions (including SFCs)	4,205		24.42	
(ii) Government	60		0.35	
(iii) Banks (short term)	2,662		15.46	
(iv) Capital market	1,650		9.38	
		17,216		100.00

SOURCE : Vinay D. Lall "Financing of Private Corporate Sector-An Assesment of Expert Study Group's Report" Economic and Political Weekly ,August 6 , 1988.

Table III

Financing of gross fixed assets of corporate sector by retained profits and new issues [a detailed break up] (Rs. '000)

	1.	2		3		4	
Years	G.F.A.E.	G.I.E.	(2/1)%	R.P.	(3/1)%	N.E.	(4/1)%
1971-72	37808	39866	105.44	12280	32.32	2492	6.59
1974-75	69094	65061	94.16	30021	43.44	2895	4.19
1977-78	75366	46083	61.16	5067	6.72	2863	4.20
1980-81	151200	104203	68.91	43200	28.57	2912	1.93
1981-82	173474	112322	64.74	36720	21.16	7833	4.51
1982-83	190462	114560	60.14	32433	17.02	11566	6.07
1983-84	198154	117622	59.36	34304	17.31	23513	11.86
1984-85	241434	166384	68.91	51741	21.93	10841	4.49
1985-86	271541	201588	74.23	72195	26.58	34362	12.65
1986-87	310493	178068	57.35	51101	16.46	40053	12.89

NOTE :- G.F.A.E denotes Gross Fixed asset Expenditure, G.I.E. denotes Gross Internal savings, R.P. denotes Retained Profits, N.E. denotes New Issues

SOURCE :- Compiled from various issues of RBI Bulletin : Finance of medium and large public limited companies.

Table IV

Assistance sanctioned by financial institutions

Year	Sanction (Rs. crores)	Annual rate of growth
1964-65	118.1	11.57%
1970-71	254.2	20.59%
1975-76	648.3	31.25%
1980-81	2525.8	8.79%
1981-82	2746.8	17.65%
1982-83	3231.7	27.35%
1983-84	4115.6	37.22%
1984-85	5647.6	-----
1985-86	6613.1	17.09%
1986-87	8157.2	23.33%
cumulative upto March 87	40544.8	------

NOTE :- Average annual rate of growth from 1964 to 87--20.22%

SOURCE :- IDBI Report on Development Banking in India 1986-87

Table V

Sector wise assistance sanctioned by financial institutions (Rs. crores)

Year	Public	Joint	Co-operative	Private	Total
1984-85	668.0	363.9	95.3	4203.5	5330.7
	(12.53)	(6.42)	(1.78)	(78.85)	(100.00)
1985-86	1235.7	411.2	157.8	4604.8	6409.1
	(19.27)	(6.42)	(2.46)	(71.85)	(100.00)
1986-87	1256.7	675.1	152.0	5727.9	7811.7
	(16.08)	(8.64)	(1.95)	(73.32)	(100.00)
Cumulative upto March 1987	5632.1	3001.3	1281.9	29487.1	39402.9
	(14.29)	(7.62)	(3.25)	(74.83)	(100.00)

NOTE :- Figure in bracket indicate percentages.

SOURCE :- IDBI Rport on Development Banking 1986-87

Table VI

Component wise assistance sanctioned by Financial Institutions.[Rs.Crores

Year	Rupee loans	Foreign currency loans	Underwriting direct subscription guarantees	Total
1964-65	77.4	-----	38.7	116.1
	(66.66)	-----	(33.34)	(100)
1970-71	227.00	53.40	30.78	311.18
	(72.94)	(17.16)	(9.90)	(100.00)
1981-82	2394.98	153.53	416.48	2964.99
	(80.77)	(5.17)	(14.06)	(100.00)
1984-85	4335.4	334.9	977.30	5647.6
	(76.76)	(5.94)	(17.30)	(100.00
1985-86	5032.8	463.8	1116.5	6613.1
	(76.10)	(7.02)	(16.88)	(100.00
1986-87	6143.1	829.8	1184.3	8157.2
	(75.30)	(10.5)	(14.52)	

NOTE :- [Fugures in brackets indicate percentages]

SOURCE :- (i) **IDBI** Operational report for various years.
(ii) **IDBI** Report on Development Banking **1986-87**.
(iii) **RBI** Reports on currency and finance.

Table VII

Ownership pattern of corporate securities (1986)

(Percentages of paid up value of holdings)

Category	Equity shares	Preference	Debenturce	Cnvertible Debenturce
1. Idividuals	41.93	15.14	30.33	54.11
2. Financial Inst.	23.95	72.93	62.66	36.19
3. Govt.& semi Govt.	0.22	3.10	0.43	0.00
4. Joint stock Comp.	32.26	6.19	3.07	8.08
5. Trusts & Charitable Institutions	0.33	0.30	2.13	0.15
6. Others	1.31	2.34	1.78	1.47
	100.00	100.00	100.00	100.00

SOURCE :- Compiled from **IDBI** Report on Ovnership pattern of shares an debentures of Companies (abridged and rearranged)

Table VIII

Ownership pattern of equity shares of private corporate sector by Financia Institutions (Percentages of paid up value)

Category	1978	% to total	1986	% to total
IDBI	1.06	3.87	3.73	15.57
ICICI	0.49	1.80	0.97	4.05
IFCI	0.50	1.83	1.01	4.22
IRBI	0.00	0.00	0.00	0.00
UTI	4.90	17.90	3.92	16.37
LIC	7.76	28.36	4.10	17.11
GIC	5.52	20.16	3.54	14.78
Others	7.14	26.08	5.13	21.40
Total	27.37	100.00	23.95	100.00

NOTES :- Others include (i) Public sector commercial Banks and other Banks
(ii) State level Financial Institutitons.

SOURCE :- Compiled from (i) **RBI** Bulletin, Bebruay **1989**.
(ii) **IDBI** Report ibid table **1989**.
[re-arranged and abridged]

Table IX

Industry-wise Ownership pattern of equity shares (per cent)

Category of ownership		Financial Inst.	Industrials	Govt. bodies	Joint stock Companies	Other	Total
Industry groups	Ranks	Holdings					
E.G.	1	56.69	41.46	0.60	0.00	1.25	100
P.& P.P.	2	40.52	23.95	22.95	13.33	0.11	100
B.M.& A.	3	27.42	46.70	0.00	15.85	10.03	100
R.& R. P.	4	27.02	37.56	1.05	34.13	0.24	100
N.M.M.P.	5	25.68	43.75	10.94	19.67	0.14	100
TEXTILES	6	24.39	40.88	6.75	27.13	0.85	100
M.O.T.E	7	22.87	38.87	0.94	36.19	1.73	100
E .M.	8	22.84	38.30	6.23	31.46	1.77	100
C . P.	9	22.76	34.90	10.39	29.48	2.47	100
L.& L.P	10	20.23	26.20	25.00	0.90	27.07	100
MISCELL	11	20.22	46.60	5.75	27.30	0.13	100
T .E	12	19.50	41.24	2.43	36.43	0.13	100
B.M.& A	13	17.93	27.06	38.87	14.98	1.16	100
MUL. PR	14	17.45	29.43	30.82	21.69	0.61	100
M. F.P	15	16.22	46.77	8.44	28.64	0.33	100
O.T.	16	13.07	24.43	0.00	62.50	0.00	100
J.T.	17	3.74	9.44	65.42	21.03	0.37	100
H & R	18	2.37	36.50	0.00	61.13	0.00	100

NOTES:-E. G. denotes Electricity Generation , **P&PP** denotes Paper and Paper Products ,**BM&A** denotes Basic Metals and Alloys, **R&RP** denotes Rubber & Rubber Products , NMNP- Non Mettalic Mineral Products , **MOTE-** Machinery other than Electricals ,**EM-** Electrical Machinery , CP- Chemical Products ,**L&LP-**Leather and Leather Products ,**TE-** Transport Equipment ,**BM&A-** Basic Metals & alloys **MUL. PR-** Multi Products ,**MFP-** Manufacture of Food Products ,**OT-** Other Textiles **JT-** Jute Textiles ,**H&R-** Hotels and Resturants.

SOURCE :- **IDBI** Report on Ownership Pattern of Shares and Debentures Companies . **1989** (Rearranged)

Table X

Distribution of companies according to size of individual equity holdings and institutional equity holdings

		Range				N.A.	PV	AV
		Upto 25%	25%-40%	40%-50%	> 50%			
IND	No of companies	148	122	90	215	7593213	986.4	0.013
		(25.74)	(21.22)	(15.65)	(37.39	(99.54)	(35.79)	
FI	No of companies	366	101	50	58	5893	623.2	10.57
		(63.65)	(17.56)	(8.69)	(10.10)	(0.0007)	(22.62)	

Notes:- I N D denotes Individuals , F I denotes Financial Institutions

N. A. - Number of Accounts , P. V. -Paid up value (Rs. crores)

A. V. -Average size (Rs. Lakhs)

Total number of companies in the sample 575 ,

Total number of accounts - 7628598

Total paid up value of holding (Rs. crores) - 2755.48

Figures in brackets denote percentages.

SOURCE :- Compiled from IDBI Report on Ownership Pattern of Shares and Debentures of Companies 1989 (Abridged and Rearranged)